

REPORT OF EXAMINATION
OF THE
STANDARD GUARANTY INSURANCE COMPANY
AS OF
DECEMBER 31, 2005

I, Matthew Denn, Insurance Commissioner of the State of Delaware, do hereby certify that the attached REPORT ON EXAMINATION, made as of DECEMBER 31, 2005 of the

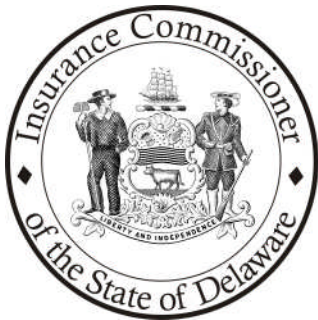
STANDARD GUARANTY INSURANCE COMPANY

is a true and correct copy of the document filed with this Department.

ATTEST BY:

Antoinette Handy

DATE: 29 JUNE 2007



In Witness Whereof, I HAVE HEREUNTO SET MY HAND AND AFFIXED THE OFFICIAL SEAL OF THIS DEPARTMENT AT THE CITY OF DOVER, THIS 29TH DAY OF JUNE 2007.

Matthew Denn

Insurance Commissioner

REPORT ON EXAMINATION
OF THE
STANDARD GUARANTY INSURANCE COMPANY
AS OF
December 31, 2005

The above captioned Report was completed by examiners of the Delaware Insurance Department.

Consideration has duly been given to the comments, conclusions, and recommendations of the examiners regarding the status of the Company as reflected in the Report.

This Report is hereby accepted, adopted, and filed as an official record of this Department.

A handwritten signature in black ink, appearing to read "Matt Denn", is written over a horizontal line.

MATTHEW DENN
INSURANCE COMMISSIONER

DATED this 29TH Day of JUNE 2007.

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May 30, 2007

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Honorable Matthew Denn
Insurance Commissioner
Delaware Department of Insurance
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Dover, Delaware 19904

Dear Commissioners:

In compliance with instructions and pursuant to statutory provisions contained in Certificate of Authority No. 06.036, dated October 5, 2006 an Association examination has been made of the affairs, financial condition and management of the

STANDARD GUARANTY INSURANCE COMPANY

hereinafter referred to as "Company," incorporated under the laws of the State of Delaware as a stock company with its statutory home office located at 2711 Centerville Road, Suite 400, Wilmington, Delaware. The examination was conducted at the principal office of the Company, located at 11222 Quail Roost Drive, Miami, Florida.

The Report of such examination is submitted herewith.

SCOPE OF EXAMINATION

The last examination was conducted as of December 31, 2002. This examination covered the period from January 1, 2003 through December 31, 2005, and consisted of a general survey of the Company's business policies and practices, management, any corporate matters incident thereto, a verification and evaluation of assets and a determination of liabilities. Transactions subsequent to the latter date were reviewed where deemed necessary.

This Report is presented on an exception basis. It is designed to set forth the facts with regard to any material adverse findings disclosed during the examination. The text will explain changes wherever made. If necessary, comments and recommendations have been made in those areas in need of correction or improvement. In such cases, these matters were thoroughly discussed with responsible Company officials during the course of the examination.

The general procedures of the examination followed the rules established by the Committee on Financial Condition Examiners Handbook of the National Association of Insurance Commissioners (NAIC) and generally accepted statutory insurance examination standards consistent with the Insurance Laws and Regulations of the State of Delaware. In accordance with the aforementioned Handbook, the consulting firm of INS Service, Inc performed a limited information systems review.

The 2002 examination was conducted by the Delaware Insurance Department in accordance with the Association Plan of Examination guidelines established by the NAIC. The Company's parent, American Security Insurance Company, a Delaware domestic insurance company, was examined concurrently with this examination.

In addition to items hereinafter incorporated as a part of the written report, the following areas were checked and made part of the files of this examination.

Fidelity Bonds and Other Insurance
Statutory Deposits
Employees' Welfare
All Asset and Liability Items not mentioned

HISTORY

The Company was incorporated under the laws of Georgia on August 29, 1960, and commenced business September 12, 1960. On January 1, 1984, the Company merged with Standard Guaranty Insurance Company of Delaware, a Delaware corporation incorporated on September 16, 1983. At the date of the merger, the domicile was changed from the State of Georgia to the State of Delaware.

American Security Insurance Company, a Delaware corporation, owns all outstanding stock of the Company. American Security is, in turn, wholly owned by Interfinancial, Inc., a Georgia insurance holding company. Interfinancial, Inc., is owned by Assurant, Inc., a Delaware corporation equally owned by Fortis N.V. (The Netherlands) and Fortis SA/NV (Belgium).

CAPITALIZATION

Common Capital Stock

As of December 31, 2005, the Company's common capital stock is represented by 1,075 shares authorized and issued at \$3,300 par value, for total common capital stock of \$3,547,500. American Security Insurance Company, a Delaware corporation, owns 100% of the outstanding stock.

Dividends to Stockholder

The following dividends were paid to the stockholder:

2003	\$ 8,750,000
2004	\$ 0
2005	\$ 25,000,000

The dividends were approved in the board minutes and proper filings were made to the Delaware Department of Insurance.

Gross Paid In and Contributed Surplus

At the prior examination as of December 31, 2002, gross paid in and contributed surplus amounted to \$1,802,500. During the period of this examination, Gross Paid In and Contributed Surplus in the amount of \$1,802,500 remained unchanged.

Changes in Surplus

Common capital stock	\$3,547,500	
Gross paid-in and contributed surplus	1,802,500	
Unassigned funds	<u>25,371,097</u>	
Surplus at December 31, 2002		\$30,721,097
Net income	\$39,757,632	
Change in net unrealized capital gains or (losses)	(374,629)	
Change in net deferred income tax	964,082	
Change in non-admitted assets	581,587	
Change in provision for reinsurance	(2,510,000)	
Dividends to stockholders	(33,750,000)	
Prior period unearned ceding fees, net of taxes	<u>(926,922)</u>	
Change in surplus during the examination period		<u>\$3,741,750</u>
Surplus at December 31, 2005		<u>\$34,462,847</u>

MANAGEMENT AND CONTROL

Directors

A review of the minutes of the sole shareholder of the Company for the three-year period of examination reflects that the Board of Directors was duly elected for each of the respective years. Names of directors were compared to the respective Annual Statement jurat pages without exception. Those directors serving at December 31, 2005 were as follows:

<u>Name</u>	<u>Affiliation</u>
Robert Brian Pollock New York, NY	President and Chief Operating Officer of Assurant, Inc.; Chief Executive Officer and Director of American Security Insurance Company; Director of Union Security Life Insurance Company and, of the Company
Philip Bruce Camacho Cumming, GA	Executive Vice President and Chief Financial Officer of Assurant, Inc.; President and Director of American Security Insurance Company; Director of Union Security Life Insurance Company and, of the Company
Jon Kerry Clayton Summit, NJ	Chief Executive Officer and Vice Chairman of the Board of Directors of Assurant, Inc.; Director of American Security Insurance Company, Union Life Insurance Company and, of the Company
Jerome Adolphus Atkinson Montclair, NJ	Executive Vice President and Chief Compliance Officer of Assurant, Inc.; Director of American Security Insurance Company, Union Security Life Insurance Company and, of the Company
Adam David Lamnin Miami, FL	Group Senior Vice President and Director of American Security Insurance Company and, of the Company

Steven Craig Lemasters
Atlanta, GA

Group Senior Vice President and Director of
American Security Insurance Company, Union
Security Life Insurance Company and, of the
Company

John Buster Owen
Clanton, NJ

Senior Vice President and Director of
American Security Insurance Company and, of
the Company

Officers

Corporate minutes were obtained and reviewed for each of the three years of examination.

Names of officers were compared to the respective Annual Statement title page and jurat. Those officers serving at December 31, 2005 were as follows:

<u>Name</u>	<u>Affiliation</u>
Steven Craig Lemasters	President
Arthur William Heggen	Secretary
Kenneth Edward Lacy*	Treasury
Adam David Lamnin	Group Senior Vice President
Michael David Anderson	Senior Vice President
Manuel Jose Becerra	Senior Vice President
Gary (nmn) Bursevich	Senior Vice President
Joseph Edward Erdeman	Senior Vice President
Russell Gary Kirsch	Senior Vice President
Katharine Ann McDonald	Senior Vice President
John Buster Owen	Senior Vice President
Terri Lynette Prestage-White	Senior Vice President
Allen Floyd Tuthill	Senior Vice President
Karen Porter Wolf	Senior Vice President
Gary James Novak	Assistant Treasurer

*Subsequent to the date of examination, Kenneth Edward Lacy resigned. On April 24, 2006, Amelia Toural was elected Treasurer of the Company.

Conflict of Interest

The Company appears to have an adequate policy and statement concerning conflict of interest, and directors, officers and key employees sign the conflict of interest statements each

year. These statements were reviewed for the three-year period of examination with no exceptions noted.

HOLDING COMPANY SYSTEM

The Company is a member of an Insurance Holding Company System. The Company is a 100% owned subsidiary of American Security Insurance Company (ASIC), a Delaware corporation. In turn, ASIC is a direct owned subsidiary of Interfinancial, Inc., a Georgia corporation. Interfinancial, Inc. is a wholly owned subsidiary of Assurant, Inc., a Delaware corporation. The ultimate parents of the system are the Belgian company Fortis (SA/NV), and its Dutch counterpart, Fortis N.V.

Assurant Inc., was the subject of an initial public offering in February 2004 when its former parent Fortis (SA/NV) / Fortis N.V. sold approximately 65% of its interest and, then later, in January 2005, in a secondary offering sold another approximate 19%. Fortis currently retains an approximate 16% ownership of Assurant, Inc., common stock, which is committed to satisfy mandatorily exchangeable bonds it has issued.

The following is an organizational chart that reflects the identities and interrelationships between the Company, parent, affiliated insurers, and other members of the system as of December 31, 2005:

Fortis (SA/NV) and Fortis N.V.	Owns 16% of shares of Assurant, Inc.
Assurant, Inc.	Owns 100% of Interfinancial, Inc.
Interfinancial, Inc.	Owns 100% of American Security Insurance Company
American Security Insurance Company	Owns 100% of Standard Guaranty Insurance Company Owns 100% of Union Security Life Insurance Company

Copies of the Form B Holding Registration Statements filed with the Delaware Department of Insurance during the period under examination were reviewed in conjunction with the review of the management, service, and tax agreements in place during the period of examination. This review indicated that the Company complied with the provisions of Regulation 13 of the Delaware Insurance Statutes.

MANAGEMENT AND SERVICE AGREEMENTS

Agreements with Affiliates

The Company participated in a variety of agreements, as summarized below, with its affiliates. The agreements were submitted to, and subsequently approved by, the Delaware Department of Insurance. The agreements were filed in compliance with requirements of 18 Del. C. § 50 (Insurance Holding Company System Registration Act) and 18 Del. Admin. Code 1304 § (Holding Company System Forms and Instructions).

Management Agreements

A management agreement, effective January 1, 1994 between Fortis, Inc. (Fortis) and the Company, provides for Fortis to perform various management support services including financial reporting, systems development and other information technology functions. In return, the Company pays Fortis an annual management fee based on its pro-rata allocation share of Fortis' allocable operating expenses. Either party may terminate this agreement upon 30 days written notice.

An agreement between the Company and its parent, American Security Insurance Company (ASIC), effective January 1, 2002, provides for ASIC to perform various management support functions including risk management, administration, executive compensation, staffing,

marketing and others, on behalf of the Company, in return for an annual management fee equal to the pro rata share of costs incurred by ASIC on behalf of all of its subsidiaries. This agreement continues in force until terminated by either party upon 30 days written notice.

Administrative Services Agreement

An administrative services agreement, effective January 1, 1996 between the Company, ASIC, and Fortis Benefits Insurance Company (FBIC) provides for FBIC to perform administrative services relating to policy issuance, product pricing, data and premium collection, and other services. This agreement continues in force until terminated by either party with 90 days written notice of its intent to terminate.

Federal Tax Allocation Agreement

This agreement, effective August 9, 2004 between Assurant, Inc., and several of its subsidiaries, including this Company, provides for the combined group to file a consolidated income tax return and for the allocation of their consolidated tax liability. The method of allocation is in accordance with Treasury Regulations 1.1552-1 and 1.1502-33. All settlements under the agreement are to be made within 30 days of filing the federal corporate income tax return or receipt of a refund.

A new federal tax allocation agreement was executed effective February 27, 2006. The terms are the same on the 2006 Federal Tax Allocation Agreement as the 2004 Agreement; however, the participants have changed.

Investment Management Agreement

This agreement, effective January 1, 1995 between Fortis and the Company, provides for Fortis, through its affiliate Fortis Asset Management, to perform services to include investment advice, accounting services, and other services necessary to manage the Company's investment

portfolio in return for an annual fee. This agreement was assigned with the Company's consent, to Fortis Advisers, Inc., effective January 1, 1996. It was then re-assigned back to Fortis, effective March 31, 2001.

General Agency Agreement

This agreement, effective July 1, 1997 between the Company, American Security Insurance Company, and Insureco Services, Inc. (Insureco), authorizes Insureco to sell policies, collect premiums and settle claims on behalf of SGIC and ASIC, for hazard insurance policies (forced-placed coverage) to various banks and finance companies.

Agreements with Non-Affiliates

Custodial Agreement

Assurant, Inc., on behalf of its subsidiaries, has a "Master Custody Agreement" with an NAIC approved custodian, dated May 31, 1991, with respect to the custody and management of its investments. This agreement was amended and restated as of September 1, 2005.

In reviewing this agreement, it was noted that the agreement does not contain the following recommended clause, "In the event that the custodian gains entry in a clearing corporation through an agent, there should be a written agreement between the custodian and the agent that the agent shall be subjected to the same liability for loss of securities as the custodian. If the agent is governed by laws that differ from the regulation of the custodian, the Commissioner of Insurance of the state of domicile may accept a standard of liability applicable to the agent that is different from the standard liability."

Therefore,

It is recommended that the Company amend the custodial agreement to incorporate all safeguards as recommended in the *NAIC Financial Condition Examiners' Handbook*, Part 1, Section IV, Paragraph J.

Investment Management Agreements

In addition to the Investment Management Agreement with Fortis, discussed in this report under “Agreements with Affiliates,” the Company has two asset management agreements with non-affiliates.

Discretionary Investment Management Agreement of 2000

On December 1, 2000, Fortis Advisers, Inc., entered into a Client Agreement and Trading Authorization under which an investment manager has discretionary authority to buy, sell and trade in preferred stocks and bonds. The investment manager agreed to act only in accordance with the Company’s investment guidelines and all applicable regulatory guidelines, which were attached to the Agreement. The Agreement contains a clause indemnifying the Company for damages arising from the investment manager’s breach of contract or gross negligence or willful misconduct.

Discretionary Investment Management Agreement of 2004

On September 28, 2004, Assurant Asset Management entered into a Discretionary Investment Advisory Agreement providing for a discretionary investment manager. The investment manager does not have possession or custody of any assets and is not responsible for any custodial arrangements involving any assets in the investment account. The investment manager indemnifies the Company for errors in judgment or acts or omissions to act resulting from its negligence, willful misconduct, malfeasance, or material breach of the agreement. The investment manager supervises and directs the investments in accordance with the written investment objectives, policies and restrictions provided by the Company.

TERRITORY AND PLAN OF OPERATION

Territory

During the examination, the Company's certificates of authority were reviewed without exception. As of December 31, 2005, the Company was licensed in the following jurisdictions:

Alabama	Kansas	North Dakota
Arizona	Kentucky	Ohio
Arkansas	Louisiana	Oklahoma
California	Maryland	Oregon
Colorado	Michigan	Rhode Island
Delaware	Minnesota	South Carolina
District of Columbia	Mississippi	South Dakota
Florida	Missouri	Tennessee
Georgia	Montana	Utah
Hawaii	Nebraska	Vermont
Idaho	Nevada	Virginia
Illinois	New Hampshire	Washington
Indiana	New Jersey	West Virginia
Iowa	New Mexico	Wisconsin
	North Carolina	

In addition, the Company has a certificate of authority qualifying as an acceptable surety for federal bonds and a certificate of surplus line insurer eligibility from Puerto Rico.

Plan of Operation

The US operations are run by Assurant, Inc., in four operating business segments; Assurant Solutions, Assurant Health, Assurant Employee Benefits, and Assurant PreNeed. The Assurant Group has operations throughout the US and has established operations in Brazil and Canada.

The Company is authorized to write the following lines of business: health, surety, marine and transportation, property and casualty, leakage and fire extinguisher equipment, theft and burglary, vehicle, and liability insurance.

Banks and finance companies located throughout the US write business. The Company has one corporate agent that is an affiliate, Insureco. Insureco procures hazard insurance (forced-placed coverage) for various financial institutions on the Company's paper. Insureco collects premium payments, deducts the Insureco commission and remits net to the Company's parent ASIC.

The 2005 Annual Statement indicates that direct business written was as follows:

Fire	\$ 66,065,774
Allied lines	16,786,265
Homeowners multiple peril	4,545,894
Inland marine	903,384
Group accident and health	298
Credit accident and health	4,008,171
Auto physical damage	119,765
Credit	241,402
Miscellaneous casualty	<u>12,094,898</u>
Total	<u>\$104,765,851</u>

GROWTH OF COMPANY

The following information was obtained from the Company's filed Annual Statements:

<u>Year</u>	<u>Admitted Assets</u>	<u>Surplus</u>	<u>Premiums Earned</u>	<u>Net Income</u>
2005	\$124,776,981	\$35,205,847	\$81,630,402	\$14,072,294
2004	109,337,587	46,693,192	55,587,331	23,225,579
2003	93,624,468	25,411,978	69,033,395	2,459,759
2002	95,943,772	30,721,097	32,976,369	7,136,517

The assets of the Company increased 30% from 2002 to 2005. Premiums earned increased 147.5% during that period. Surplus as Regards Policyholders increased from \$30.7 million to \$35.2 million, an increase of 14.6%, primarily attributable to net income of \$39.8

million less dividends to parent of \$33.8 million. Net income increased 97.2% during the period from 2002 to 2005.

REINSURANCE

During 2005, the Company both ceded and assumed reinsurance. The 2005 Annual Statement indicates the following:

Direct business	\$104,765,851
Assumed from affiliates	0
Assumed from non-affiliates	368,866
Ceded to affiliates	(0)
Ceded to non-affiliates	<u>(23,504,315)</u>
Net premiums written	<u>\$81,630,402</u>

Assumed

Business was assumed from one reinsurer. The premiums assumed consisted of allied lines.

Ceded

Business is ceded to about 35 different reinsurers. The following four reinsurers represent approximately 80% of premiums ceded during 2005:

<u>Authorized Reinsurers</u>	
Centurion Casualty Company	\$1,684,000
Citicorp Assurance Company	1,615,000
<u>Unauthorized Reinsurers</u>	
Marion Insurance Company	\$7,605,000
Chase Reinsurance Ltd	7,924,000

The treaties above were all quota share arrangements, with cession percentages ranging from 95% to 100%. Approximately 87% of the premiums ceded were for fire and allied lines.

The balances due from the unauthorized reinsurers are secured by either Funds Held by Company, letters of credit, or by assets held in trust under a trust agreement.

In addition to the above, other major reinsurance agreements protecting the Company's exposure as of December 31, 2005 were as follows:

<u>Treaty</u>	<u>Description</u>	<u>Company Retention</u>	<u>Limits</u>
Property			
Casualty	1 st layer per occurrence	\$ 25,000,000	\$25,000,000
	2 nd layer	\$ 50,000,000	\$35,000,000
	3 rd layer	\$ 85,000,000	\$45,000,000
	4 th layer	\$130,000,000	\$55,000,000
	5 th layer	\$185,000,000	\$15,000,000
	6 th layer	\$200,000,000	\$10,000,000

FIDELITY BONDS AND OTHER INSURANCE

The Company is covered under a standard financial institution bond covering Assurant, Inc., and its subsidiary companies. Fidelity coverage under that bond met the minimum amount of fidelity insurance suggested by the NAIC. The Company is also the named insured on other policies that include:

- Directors' and officers' liability and company indemnification
- Commercial auto policy
- Workers' compensation and employers' liability policy
- Commercial excess liability policy
- Commercial umbrella
- Financial institutions policy
- Excess indemnity policy

ACCOUNTS AND RECORDS

The accounts and records reviewed included an evaluation of the Company's operational and organizational controls. The areas evaluated included computer systems, accounting systems, organizational structure, and the processing structure.

During the examination, the Company's books and records were reviewed and compared to reported items and values in the Annual Statements. A trial balance for the final year under review was obtained and traced to the Company's Annual Statement.

Examination Delays

During this examination, examiners experienced considerable delays in obtaining requested information, and received incorrect or incomplete information on a number of occasions. These circumstances contributed greatly toward expanding the amount of time necessary to complete this examination.

Therefore:

It is recommended that the Company take steps to insure the timely and accurate delivery of supporting documentation to examiners for review.

Aging of Agents' Balances

During the testing of premiums written, it was noted that for various programs the Company does not maintain policy level detail within its premiums system which would permit the reporting and aging of agents' balances on a policy level basis. This is not in compliance with SSAP 6, Paragraph 9c of the *NAIC Accounting Practices and Procedures Manual*, which requires policy level reporting and aging of agents' balances.

Therefore:

It is recommended that in the future the Company report and age agents' balances on a policy level basis in compliance with SSAP 6, Paragraph 9c of the NAIC Accounting Practices and Procedures Manual.

Premium Data Verification

Test sampling to determine the accuracy of premium data determined that the Company's

inability to produce supporting policy files need to test the data reached unacceptable levels.

A total of 126 policy files were selected from the two systems utilized by the Company to collect and process premium data (PMS and American P&C) with a total of 119 files being provided by the Company. Of the seven files not provided, six were processed with the American P&C system and one was processed with the PMS system.

Therefore:

As recommended in the prior examination reports dated December 31, 1999 and December 31, 2002, it is again recommended that the Company improve its control over policy files and implement procedures for the retrieval of policy files so as to insure the availability of all policy files for the purpose of examination.

The 119 policy files received as part of the data verification testing were reviewed and tested for a total of 504 attributes. A total of two errors were found in that testing, with one error being on items processed with each of the systems.

Therefore:

As recommended in the prior examination reports dated December 31, 1999 and December 31, 2002, it is again recommended that the Company comply with Delaware Insurance Statutes, Sections 320 (c), 526 (a), 526A, and 5005 (a) (1) (d) and maintain properly documented policy files necessary for examination.

Loss Data Verification

Test sampling to determine the accuracy of premium data determined that the Company's inability to produce supporting policy files need to test the data reached unacceptable levels.

A total of 40 loss reserve files were selected from the two systems utilized by the Company to collect and process data (PMS and American P&C) with a total of 27 files being provided by the Company. Of the 13 files not provided, 12 were processed with the American P&C system and one was processed with the PMS system.

A total of 56 paid loss files were selected from the two systems utilized by the Company to collect and process data (PMS and American P&C) with a total of 41 files being provided by the Company. Of the 15 files not provided, all were processed with the American P&C systems.

Therefore:

As recommended in the prior examination reports dated December 31, 1999 and December 31, 2002, it is again recommended that the Company improve its control over both loss reserve and paid loss files and implement procedures for the retrieval of those files so as to insure the availability of all loss reserve and paid loss files for the purpose of examination.

The 27 loss reserve files received as part of the data verification testing were reviewed and tested for a total of 270 attributes. A total of 16 errors were found in that testing, with 11 errors being on items processed with the American P&C system and 5 errors on items processed with the PMS system.

The 41 paid loss files received as part of the data verification testing were reviewed and tested for a total of 451 attributes. A total of 16 errors were found in that testing, with all errors being on items processed with the American P&C system.

Therefore:

As recommended in the prior examination reports dated December 31, 1999 and December 31, 2002, it is again recommended that the Company comply with Delaware Insurance Statutes, Sections 320 (c), 526 (a), 526A, and 5005 (a) (1) (d) and maintain properly documented loss reserve and paid loss files necessary for examination.

The unreliability of this data resulted in a "Qualified Opinion" issued by the examining actuary. However, notwithstanding the unreliability of claims data, the opining actuary determined that indices imply a redundancy in the Company's reserves.

Provision for Reinsurance

The Provision for Reinsurance calculation as shown in Schedule F, Part 5, was incorrect in the 2005 Annual Statement. Schedule F, Part 5 was incorrectly completed using the values of an affiliated company, rather than the correct values for this Company.

Letters of credit shown on Schedule F totaled \$27,176,000; the total should have been \$0. Trust accounts shown on Schedule F totaled \$3,837,000; the total should have been \$4,029,000. Due to the above, the Provision for Reinsurance was reported at \$1,767,000; the total should have been \$2,510,000. As shown in Note 3, these amounts are reported correctly in this Report. Therefore:

It is recommended that the Company exercise greater care in the preparation of the Annual Statement and more thoroughly review the Annual Statement to prevent such errors from occurring in the future.

Disclosure of Unsecured Reinsurance Recoverables

As noted in the prior examination report, SSAP 62, Paragraph 65 (a) requires disclosures as follows, "If the entity has with any individual reinsurers, authorized or unauthorized, an unsecured aggregate recoverable for losses, paid and unpaid including IBNR, loss adjustment expenses, and unearned premium, that exceeds 3% of the entity's policyholder surplus, list each individual reinsurer and the unsecured aggregate recoverable pertaining to that reinsurer." This error was also noted in the 2002 examination and brought to the attention of management.

The reinsurance amounts recoverable from the Centurion Casualty Insurance Company and Marion Insurance Company are in excess of 3% of surplus and are not secured. The required disclosures were not made in Footnote 23 A.

Therefore:

It is again recommended that in future annual statement filings the Company make disclosures as required under SSAP 62 and properly disclose any reinsurance recoverables in excess of 3% of surplus that are not secured.

Disclosure of Managing General Agent

The Company continued to erroneously report an unaffiliated company as a managing general agent (MGA) in Footnote 19 of the 2005, 2004, and 2003 Annual Statements. This error was also noted in the 2002 examination and brought to the attention of management. The Company finally corrected this error in its footnotes to the 2006 Annual Statement.

Therefore:

It is recommended that the Company be more diligent in ensuring the accuracy of its Annual Statement *Notes to Financial Statements*.

FINANCIAL STATEMENTS

The following statements show the assets, liabilities, surplus and other funds of the Company, as determined by this examination, as of December 31, 2005.

Assets
Liabilities, Surplus and Other Funds
Statement of Income
Capital and Surplus Account
Schedule of Examination Adjustments

It should be noted that the various schedules and exhibits may not add to the totals shown due to rounding.

AssetsDecember 31, 2005

	Assets	Non-admitted Assets	Net Admitted Assets	
Bonds	\$ 98,751,020	\$ 0	\$ 98,751,020	Note 1
Preferred stocks	7,333,204		7,333,204	
Common stocks	204,987		204,987	
Cash and short-term investments	(2,150,341)		(2,150,341)	
Collateral held under securities lending	1,791,250		1,791,250	
Investment income due and accrued	1,260,346		1,260,346	
Premiums and agents' balances in course of collection	956,686		956,686	
Premiums, agents' balances and installments booked but deferred and not yet due	522,895		522,895	
Amounts recoverable from reinsurers	749,073		749,073	
Other amounts receivable under reinsurance contracts	1,023,545		1,023,545	
Current federal and foreign income tax recoverable and interest thereon	889,516		889,516	
Net deferred tax asset	4,054,522	177,945	3,876,577	
Guaranty funds receivable or on deposit	86,876		86,876	
Receivables from parent, subsidiaries, and affiliates	9,262,713		9,262,713	
Premium tax recoverable	209,845		209,845	
Miscellaneous assets	8,789		8,789	
Total Assets	<u>\$124,954,926</u>	<u>\$177,945</u>	<u>\$124,776,981</u>	

Liabilities, Surplus and Other Funds

December 31, 2005

Losses	\$ 7,856,637	Note 2
Loss adjustment expenses	1,021,606	Note 2
Commissions payable, contingent commissions and other similar charges	11,564,118	
Other expenses	30,268	
Taxes, licenses and fees	1,122,319	
Unearned premiums	47,049,097	
Ceded reinsurance premiums payable	1,726,429	
Funds held by Company under reinsurance treaties	571,590	
Amounts withheld or retained by Company for account of others	314,535	
Remittances and items not allocated	4,651	
Provision for reinsurance	2,510,000	Note 3
Payable to parent, subsidiaries and affiliates	9,980,081	
Payable for securities	1,009,157	
Contingent legal reserve	520,833	
Obligation under securities lending	1,791,250	
Agents' credit balance	1,849,807	
Unearned ceding fees	<u>1,391,756</u>	
 Total Liabilities	 <u>\$ 90,314,134</u>	
 Common capital stock	 \$3,547,500	
Gross paid in and contributed surplus	1,802,500	
Unassigned funds (surplus)	<u>29,112,847</u>	
 Surplus as regards policyholders	 <u>\$ 34,462,847</u>	
 Total Liabilities and Surplus	 <u>\$124,776,981</u>	

Statement of Income

December 31, 2005

Underwriting Income	
Premiums earned	\$70,233,649
Deductions	
Losses incurred	17,200,223
Loss expenses incurred	4,074,958
Other underwriting expenses incurred	30,385,444
Change in contingent legal reserve	<u>268,750</u>
Net underwriting gain	\$18,304,274
Investment Income	
Net investment income	\$5,105,634
Net realized capital gains (losses)	<u>(264,952)</u>
Net investment gain	\$ 4,840,682
Other Income	
Finance and service charges not included in premiums	<u>14,403</u>
Net income before federal taxes	\$23,159,359
Federal taxes incurred	<u>(9,087,065)</u>
Net Income	<u><u>\$ 14,072,294</u></u>

Capital and Surplus AccountDecember 31, 2004 to December 31, 2005

Surplus as Regards Policyholders, December 31, 2004		\$ 46,693,192
Net Income	\$14,072,294	
Net unrealized capital losses	(175,700)	
Change in net deferred income tax	1,009,264	
Change in nonadmitted assets and related items	366,797	
Change in provision for reinsurance	(2,503,000)	
Dividends to stockholders	<u>(25,000,000)</u>	
Net change in capital and surplus for the year		<u>\$(12,230,345)</u>
Surplus as Regards Policyholders, December 31, 2005		<u>\$ 34,462,847</u>

Schedule of Examination Adjustments

	<u>Per</u> <u>Company</u>	<u>Per</u> <u>Examination</u>	Surplus Increase (Decrease)
<u>Liabilities</u>			
Provision for reinsurance	\$1,767,000	\$2,510,000	\$ (743,000)
Net Change in Surplus per Examination			<u>(743,000)</u>
Surplus per Company			<u>\$35,205,847</u>
Surplus per Examination			<u>\$34,462,847</u>

NOTES TO FINANCIAL STATEMENTS

Note 1. Bonds

\$98,751,020

The above-captioned amount, which is the same as that reported by the Company in its Annual Statement, has been accepted for purposes of this Report of Examination.

An evaluation of the Company's bond portfolio noted that 95.8% of the portfolio has an NAIC rating of 1 or 2. A review of corporate records indicated that the Board of Directors has approved the Company's bond investment transactions made during the examination period in accordance with 18 Del.C. §1304.

Note 2. Losses

\$7,856,637

Note 2. Loss Adjustment Expenses

\$1,021,606

The above-captioned amounts, which are the same as that reported by the Company in its Annual Statement, have been accepted for purposes of this Report of Examination.

The examination retained the firm of INS Consultants, Inc. (INS or Consulting Actuary) to review the Company's stated reserves. The Consulting Actuary was provided with the Company's statement of actuarial opinion and two in-house actuarial reports as the supporting documentation of the actuarial opinion with loss and loss adjustment expense reserves evaluated as of December 31, 2005. In addition, INS was provided with other reports, schedules, exhibits and relevant information as requested.

Upon reviewing the in-house actuarial reports provided, the Consulting Actuary recommends improvement in the quality of the supporting documentation. The Consulting Actuary noted that the in-house actuarial report should serve as a self-contained document in complete support of the Company loss and LAE reserves as opined in the Statement of Actuarial

Opinion, specifically that the report contain appropriate documentation sufficient for another actuary practicing in the same field to evaluate the work.

Therefore:

It is recommended that future actuarial reports which represent the supporting documentation for the Company's Statement of Actuarial Opinion contain the appropriate documentation that would be sufficient for another actuary practicing in the same field to evaluate the work.

The Consulting Actuary's review consisted of conducting an analysis of the Company's book of business by category of business on both a gross and net basis. The Consulting Actuary's estimated net loss and LAE reserves are \$2.2 million lower than the Company's booked net loss and LAE reserves of \$8.9 million. This \$2.2 million difference represents 24.8% of December 31, 2005 Annual Statement reserves.

In conjunction with the actuarial review, the examination team was tasked with verifying paid claims data. As discussed in the Accounts and Records section of this Report, test sampling to determine the accuracy of paid and outstanding claims data for the year 2005 determined that the Company's inability to produce supporting claim files needed to test the data reached unacceptable levels.

Note 3. Provision for Reinsurance

\$2,510,000

The amount per examination is \$743,000 more than the Company reported in its 2005 Annual Statement. As discussed in the Accounts and Records section of this Report, the Provision for Reinsurance calculation as shown in Schedule F, Part 5, was incorrect in the 2005 Annual Statement. The Provision for Reinsurance was reported at \$1,767,000; the total should have been \$2,510,000.

COMPLIANCE WITH PRIOR EXAMINATION RECOMMENDATIONS

There were 23 recommendations made in the prior examination report. The Company's compliance with prior examination recommendations was reviewed during the current examination. It has been determined in the current examination that the Company has complied with prior examination recommendations except as follows:

The prior examination report recommended that the Company amend the custodial agreement to incorporate all safeguards recommended in the *NAIC Financial Condition Examiners' Handbook*, Part 1, Section IV, Paragraph J. As indicated in the Agreements with Non-Affiliates section of this report, the agreement was amended. However, it still does not contain all the recommended safeguards.

The prior examination report recommended that the Company properly disclose net unsecured amounts recoverable in excess of 3% of surplus in the Notes to Financial Statements of the Annual Statement and comply with SSAP 62, Paragraph 65 (a), the *NAIC Annual Statement Instructions for Property and Casualty Companies*, the *NAIC Accounting Practices and Procedures Manual*, and 18 Del. C. § 526 (a). As indicated in the Accounts and Records section of this report, the Company has not complied with this recommendation. It is again recommended that the Company comply with SSAP 62, Paragraph 65 (a) and 18 Del. C. § 526 (a).

The prior examination report recommended that the Company implement procedures for retrieval of policy information. As noted in the Accounts and Records section of this report, the Company has not complied with this recommendation.

The prior examination report recommended that the Company comply with Delaware Insurance Statutes, Sections 320 (c), 526 (a), 526A, and 5005 (a) (1) (d) and maintain properly

documented policy files necessary for examinations. As noted in the Accounts and Records section of this report, the Company has not complied with this recommendation.

The prior examination report recommended that the Company implement procedures for retrieval of claim information. As noted in the Accounts and Records section of this report, the Company has not complied with this recommendation

The prior examination report recommended that the Company comply with Delaware Insurance Statutes, Sections 320 (c), 526 (a), 526A, and 5005 (a) (1) (d) and maintain properly documented loss reserve and paid loss files necessary for examinations. As noted in the Accounts and Records section of this report, the Company has not complied with this recommendation.

The prior examination report recommended that the Company age all outstanding debit balances based on the effective date of the underlying policy in compliance with SSAP 6, Paragraph 7 (a), 9 (a) and 9 (c). It was also recommended that the Company comply with Delaware Insurance Statutes, Section 526 (a) by filing its annual statement in compliance with *NAIC Annual Statement Instructions for Property and Casualty Companies* and the *NAIC Accounting Practices and Procedures Manual*. As noted in the Accounts and Records section of this report, the Company has not complied with this recommendation.

SUMMARY OF RECOMMENDATIONS

Custodial Agreement

It is recommended that the Company amend the custodial agreement to incorporate all safeguards as recommended in the NAIC Financial Condition Examiners' Handbook, Part 1, Section IV, Paragraph J. (Page 10)

Examination Delays

It is recommended that the Company take steps to insure the timely and accurate delivery of supporting documentation to examiners for review. (Page 16)

Aging of Agents' Balances

It is recommended that in the future the Company report and age agents' balances on a policy level basis in compliance with SSAP 6, Paragraph 9c of the NAIC Accounting Practices and Procedures Manual. (Page 16)

Premium Data Verification

As recommended in the prior examination reports dated December 31, 1999 and December 31, 2002, it is again recommended that the Company improve its control over policy files and implement procedures for the retrieval of policy files so as to insure the availability of all policy files for the purpose of examination. (Page 17)

As recommended in the prior examination reports dated December 31, 1999 and December 31, 2002, it is again recommended that the Company comply with Delaware Insurance Statutes, Sections 320 (c), 526 (a), 526A, and 5005 (a) (1) (d) and maintain properly documented policy files necessary for examination. (Page 17)

Loss Data Verification

As recommended in the prior examination reports dated December 31, 1999 and December 31, 2002, it is again recommended that the Company improve its control over both loss reserve and paid loss files and implement procedures for the retrieval of those files so as to insure the availability of all loss reserve and paid loss files for the purpose of examination. (Page 18)

As recommended in the prior examination reports dated December 31, 1999 and

December 31, 2002, it is again recommended that the Company comply with Delaware Insurance Statutes, Sections 320 (c), 526 (a), 526A, and 5005 (a) (1) (d) and maintain properly documented loss reserve and paid loss files necessary for examination. (Page 18)

Provision for Reinsurance

It is recommended that the Company exercise greater care in the preparation of the Annual Statement and more thoroughly review the Annual Statement to prevent errors from occurring in the future. (Page 19)

Disclosure of Unsecured Reinsurance Recoverables

It is again recommended that in future Annual Statement filings the Company make disclosures as required under SSAP 62 and properly disclose any reinsurance recoverables in excess of 3% of surplus that are not secured. (Page 20)

Disclosure of Managing General Agent

It is recommended that the Company be more diligent in ensuring the accuracy of its Annual Statement *Notes to Financial Statements*. (Page 20)

Actuarial Report

It is recommended that future actuarial reports which represent the supporting documentation for the Company's Statement of Actuarial Opinion contain the appropriate documentation that would be sufficient for another actuary practicing in the same field to evaluate the work. (Page 26)

CONCLUSION

The following schedule shows the results of this examination and the results of the prior examination with changes between the examination periods:

<u>Description</u>	<u>December 31, 2005</u>	<u>December 31, 2002</u>	<u>Increase or Decrease</u>
Assets	\$124,776,981	\$95,943,772	\$28,833,209
Liabilities	\$90,314,134	\$65,222,675	\$25,091,459
Capital and Surplus	\$34,462,847	\$30,721,097	\$3,741,750

In addition to the undersigned Gloria Dunn, CFE, CPA; Legh Cathey CFE; Ray Hartsfield, CFE; Robert Murphy, CFE; Mike Davis, CFE; Mary Craig Misenheimer; Joe Torres, CFE; and Robert McGee, CFE participated on this examination. Patricia Casey Davis, CFE, CPA, served as the examination supervisor.

The assistance of David J. Macesic, ACAS, MAAA, of the actuarial consulting firm, INS Consultants, Inc., is acknowledged along with the information systems consulting firm of INS Services, Inc.

Respectfully submitted,



Frank W. Brooks, CFE
Examiner-In-Charge
State of Delaware
Northeastern Zone, NAIC